JOINT INSOLVENCY EXAMINATION BOARD

Joint Insolvency Examination Board

Joint Insolvency Examination (Scotland)

Tuesday 4 November 2014

ADMINISTRATIONS, COMPANY VOLUNTARY ARRANGEMENTS and RECEIVERSHIPS (3.5 hours)

ANSWER ALL FOUR QUESTIONS

EACH QUESTION CARRIES TWENTY-FIVE MARKS

SUBMIT ALL WORKINGS

The Examiner will take account of the way material is presented. Candidates should answer the questions set - and marks will not be awarded for extraneous material.

Note: References to legislation are to that which was in force on 30 April 2014. References to 'the Act' are to the Insolvency Act 1986 as amended.

References to Sections, Schedules and Rules are to Sections and Schedules of the Act and to Rules of the Insolvency (Scotland) Rules 1986 as amended.

References to Sections and Rules of other Acts, Regulations and Orders will mention the Act, Regulation or Order.

1. Bammer Limited ("the Company") was formed in 1979 by Mrs Austin and it traded successfully until her retirement in 2010. Whilst Mrs Austin remained the sole Shareholder and a Director of the Company, at this point she appointed her son Robert Austin as Managing Director in her place.

Following his appointment Robert embarked on an ambitious plan to grow the business, taking on larger premises, more machinery and recruiting additional staff. Mrs Austin, impressed by this strategy, resigned as a Director and left the running of the Company to Robert.

Prompted to make enquiries by the Company being unable to pay her monthly dividend, Mrs Austin has discovered that it is in severe financial difficulty. As a consequence, and on a recommendation from the Company's Accountants, she and Robert met you, an Authorised Insolvency Practitioner, to discuss the situation. The notes from this meeting include the following information:

- Mrs Austin thinks that the Company's issues stem from mismanagement by her son and therefore it is her intention to work in the business again as Managing Director.

- The summarised management accounts as at 30 September 2014 are as follows:

Profit and loss account

	12 months to Dec 13 £'000	**9 months to Sept 14 £'000**
Turnover	8,750	6,300
Cost of sales	(6,550)	(5,040)
Gross profit	2,200	1,260
Overheads		
Rent	300	225
Heat light and power	100	75
Motor expenses	100	120
Wages and salaries	1,500	1,350
Other costs	110	130
Depreciation	250	240
Total overheads	2,360	2,140
Loss before interest and taxation	(160)	(880)
Interest payable	(140)	(110)
Taxation	-	-
Net loss	(300)	(990)

Balance Sheet

	Dec 13 £'000	**Sep 14 £'000**
Tangible fixed assets	1,300	1,010
Current assets		
Stock	2,000	2,200
Debtors	2,200	1,600
Other debtors	50	25
	4,250	3,825
Creditors due in less than 1 year		
Trade creditors	1,500	2,100
HMRC	100	400
Invoice Discounter	1,760	1,280
Director loan	150	50
Hire purchase	200	200
Other creditors	100	345
	3,810	4,375
Net current assets/ (liabilities)	440	(550)
Creditors due in more than 1 year		
Hire purchase	(1,000)	(800)
Net assets	740	(340)

- Up to and including September 2014 Mrs Austin continued to be paid dividends of £10,000 per month. In the future she intends to take a salary of £100,000 per annum rather than receive dividends.

- The Company pays Robert a gross salary of £25,000 per month.

- The Company's tangible fixed assets are all subject to hire purchase agreements with Bartoli Finance Limited. There are 5 years remaining on these agreements and the book value of the relevant assets included in the accounts is considered by Mrs Austin to be an accurate reflection of their realisable value.

- The Company has an invoice finance facility with Stubbs Commercial Finance Limited ("Stubbs"). This facility is supported by an assignment of the Company's trade debts to Stubbs and is normally fully utilised. The Company has experienced no bad debts or problems obtaining payment from customers. Stubbs also has a bond and floating charge registered against the Company dated 12 July 2001.

- Included within depreciation for the 9 month period is a £50,000 loss on disposal of fixed assets. The whole of this loss relates to Robert's unencumbered company car that he transferred into his personal name on 1 January 2014.

- The value of the stock held by the Company is overstated as the majority of it is old and redundant. Mrs Austin estimates that its realisable value were it to be sold in the open market is approximately 25% of book value.

Mrs Austin has researched her options and wishes to put forward a CVA to creditors. She is confident that by the time a CVA is approved the following changes can be made to the business:

- The following members of staff can be made redundant immediately without notice;

Role	**Age**	**Years' service**	**Salary £**
Sales Manager	36	2	150,000
Sales Co-ordinator	32	1	95,000
Quality Control Manager	40	3	80,000
Marketing Manager	55	4	75,000

- Robert will take a 25% pay cut as a result of his demotion to Vice Managing Director.

- The 45 remaining staff (excluding Robert and Mrs Austin) will accept a 10% pay reduction.

- Mrs Austin has concluded that Robert is a poor negotiator and, through an improved purchasing process, she is confident that the gross profit margin can immediately be increased to 30%.

- Motor expenses can be halved.

- A detailed examination of utility costs has identified that it would be possible to save 20% p.a. through changes of suppliers.

- The landlord can be persuaded to agree to a rent reduction of 25%.

- Included within other costs for the 9 month period is the full annual contract hire payment of £30,000 for a specialised printer that is no longer required. Mrs Austin would like to return this item but there are 3 remaining annual payments on the rental agreement.

The revenue of the business is not seasonal and Mrs Austin is confident that the recent level of turnover will continue for the foreseeable future.

Requirements

(a) **Based on the information provided, set out the level of monthly contributions to a CVA you would consider appropriate to be put forward to creditors. (5 marks)**

(b) **Stating appropriate assumptions, prepare a Comparative Estimated Outcome Statement for inclusion in a CVA proposal. (15 marks)**

(c) **Without listing the requirements under the Rules and Statements of Insolvency Practice, set out the key matters in these particular circumstances that you would disclose to creditors within your Nominee's report. (5 marks)**

(25 marks)

Note: Ignore Employers' National Insurance

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2. You, an Authorised Insolvency Practitioner, have been invited to a meeting with the Directors of one of your firm's audit clients, Bickerton Products Limited ("the Company") to discuss its financial position. This meeting has been arranged by an Audit Partner within your firm following a previous meeting convened to discuss the overdue outstanding audit fee of £35,000.

The Company has recently experienced cash flow pressures as a result of the following:

- A high level of bank debt repayments. The Company has a £10 million bank loan with Dechy Finance Limited ("Dechy"). The loan was originally used to acquire its only wholly owned subsidiary, Graf Design Limited ("Graf") and there are 20 quarterly capital payments remaining. Debt due to Dechy is secured by a bond and floating charge over the assets of the Company.

- Graf's £1 million overdraft provided by Dechy has been fully utilised for some time and so the Company has had to support Graf's on-going losses. Until recently the Company had been lending £200,000 per month to Graf allowing it to continue to trade. However, as the Company was unable to advance funds to cover wages the Directors of Graf closed the business last week. Graf has no assets so it is likely that it will be placed into Creditors' Voluntary Liquidation. Graf's overdraft facility is secured by a guarantee from the Company.

- The trading performance of the Company has been below expectations resulting in a breach of its banking covenants. The Directors forecast that the Company will continue to incur losses of approximately £100,000 per month.

The Directors of the Company have stated that, whilst they believe that the Company is solvent, based upon the balance sheet extracted from the 31 October 2014 management accounts (shown below), it may be necessary to place the Company into Administration because of its high levels of debt.

ASSETS	£	**LIABILITIES**	£
Fixed Assets			
Tangible assets	1,000,000		
Investment in subsidiary	7,000,000		
	8,000,000		
Current assets		***Current liabilities***	
Cash at bank	150,000	Bank loan	(2,000,000)
Stock	3,000,000	Trade creditors	(5,000,000)
Debtors	4,500,000	HMRC	(300,000)
Graf Design Limited	3,000,000	Other creditors	(200,000)
Other assets	250,000		
	10,900,000		(7,500,000)
Net current assets	3,400,000		
		Long term liabilities	
		Bank loan	(8,000,000)
Net assets	3,400,000		

Requirements

(a) **Prepare a note for the Directors outlining the conditions under which an Administrator can be appointed to the Company. Include within your note an explanation as to the meaning of insolvency and how it may apply to these circumstances. (10 marks)**

(b) **Set out alternative, non-insolvency options the Company could consider for dealing with the loan from Dechy. (5 marks)**

(c) **Summarise the responsibilities of the Directors in the period leading up to the appointment of an Administrator. (10 marks)**

(25 marks)

3. Rola Construction (Scotland) Limited ("the Company") owns a brown field site in Carnwath with planning permission to build 10 high quality residential properties ("the Project"). As a result of subsidence issues construction has been delayed and the Project is currently running 12 months behind schedule. These problems have led to additional costs that in turn have recently culminated in the main sub-contractor refusing to continue on site due to non-payment of invoices.

To date Riske Bank plc ("Riske") has provided construction funding, amounting to £1.5 million and a loan of £2.2 million for the original acquisition of the site. The debt is secured by a standard security over the site and structured so that interest only is payable during construction and the capital element is repayable from the sale of the completed properties. As a long standing provider of funding facilities to the Company, Riske also has a further security through a bond and floating charge granted by the Company on 10 November 1998.

The Company approached Riske to explain the current situation and ask for additional funding. According to the original construction plan the funding provided so far by Riske should have enabled the Company to complete 3 of the properties and reach, on average, 40% completion of the remainder. As an additional £1 million was spent upgrading the foundations, the brickwork has commenced on only 4 of the properties and the remainder are at foundation stage.

Alarmed by the significant change in the Project, Riske commissioned a property options report to identify an appropriate strategy for dealing with the situation. This report recommended that a Receiver be appointed to oversee the completion of the Project.

To avoid self-interest threats Riske operates a policy not to appoint Options Review Advisors as Receivers. Riske has therefore approached your practice with a view to your appointment as Receiver.

Requirements

(a) Set out the steps required to appoint a Receiver to the Company. (10 marks)

(b) Explain the role of a Receiver and outline their duties. (5 marks)

(c) Outline the matters you would review and the information you would require in order to establish whether or not to complete the Project. (10 marks)

(25 marks)

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4. Zardo Architectural Design LLP (“the LLP”) is a firm of Architects operating out of 5 offices throughout Scotland. The LLP comprises:

- A management board (“the Board”) of 5 Designated Partners. The Board makes all strategic decisions and has ultimate responsibility for the direction of the business; and

- A further 15 Partners that are predominantly concerned with business development and delivery of the various services provided.

The LLP has been profitable and has been paying a total of £150,000 per month to its Partners. It has a strong balance sheet but has failed to manage properly its working capital. The LLP’s work in progress is typically £6 million and debtors £4.5 million (representing 90 days’ sales). Its liabilities are paid on the due date and, apart from a bank overdraft, as at 31 October 2014 were:

- £200,000 owed to HMRC in relation to PAYE/NI due on paid October gross salaries of £600,000. The VAT liability for the quarter ended 30 September 2014 of £450,000 was paid on 28 October 2014; and

- trade creditors amounting to £50,000 representing 28 days of purchases.

In May 2013 the LLP was notified of a potential professional indemnity claim resulting from the collapse of a bridge that it designed. Whilst fortunately no one was injured in this incident, the provisional claim from the client suggested a loss of £3.5 million. The Board’s opinion was that the collapse must have been caused by poor construction rather than design and therefore this was a spurious claim. The LLP responded to its client on this basis.

After more than a year, in early September 2014 a letter before action was received from the client demanding payment of the £3.5 million. This letter was duly forwarded on to the LLP’s Professional Indemnity Insurers who responded in late September stating that, as the potential claim had not been notified to them within the time limit set out in the insurance terms and conditions, it was not covered.

During a meeting with its bank, Watson Bank plc (“the Bank”), the Board mentioned the potential claim. This resulted in the Account Manager immediately referring the LLP to the Bank’s specialist debt recovery department. A review undertaken by the debt recovery department identified that the Bank had failed to obtain any security in relation to its lending to the LLP and, due to the level of concern, the Bank immediately made demand for repayment of the overdraft.

Following a short period of negotiation, and in order to avoid having its £2.5 million fully utilised overdraft frozen, on 3 October 2014 the LLP provided the Bank with a bond and floating charge over all its assets, which was duly registered at Companies House on 10 October 2014. At the same time, all the Partners provided the Bank with individual personal guarantees amounting to £50,000 each and interest on the overdraft was frozen.

Two weeks later the LLP’s Insurance Brokers notified the LLP that it would not be possible to renew the existing professional indemnity insurance nor find cover in the market, and that cover would cease on 31 October 2014. As the LLP could not trade without insurance, the Board took insolvency advice and over the subsequent 2 weeks a buyer for the business was sought. With the agreement of the Bank, during this period the LLP continued to trade achieving a break even result and its customers continued to pay as normal.

On 31 October 2014 Administrators were appointed to the LLP and a sale of the trade and assets was completed to an unrelated third party. Consideration for this sale comprised:

- Goodwill and intellectual property £10,000
- Work in progress: 10% of book value
- Debtors: 25% of book value
- Employees: all transferred to purchaser
- Property and other leases: novated in full to purchaser
- Office equipment: £15,000

You, an Authorised Insolvency Practitioner, have been approached by a number of the LLP's Partners asking for advice on their situation and for your assistance in complying with the requests of the Administrators.

Requirements

(a) In these circumstances, explain the effect of the legislation which may affect the Bank's security position. (3 marks)

(b) Ignoring any claims that the LLP may have against its Partners, prepare a Statement of Affairs as at 31 October 2014 showing clearly how the Bank's claim would rank for dividend purposes. (14 marks)

(c) Calculate the amount for which the Partners may be liable under their personal guarantees to the Bank and outline other potential liabilities arising from the failure of the LLP for which they may also be responsible. (8 marks)

(25 marks)